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OCI NO. 6974

18 June 1954

ED

CURRENT INTELLIGENCE WEEKLY



DOCUMENT NO. 8
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CLASS. CHANGED TO: TS .S OPST
NEXT REVIEW DATE:
AUTH: HR 70-2
DATE: 7-25-79 REVIEWER:

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CENTRAL INTELLIGENCE AGENCY

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**SPECIAL ARTICLE. WESTERN EUROPE'S ECONOMIC IMPROVEMENT
AND AMERICAN POLICY OBJECTIVES Page 15**

The economy of Western Europe has shown a general improvement over the past 16 months, but basic weaknesses have not been overcome. The short-term gains and the consequent reduction in Europe's dependence on American aid have fostered a disposition toward policies not in line with American objectives.

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THE SOVIET WORLD

The Communists at Geneva still seem to believe that time is on their side on the Indochina question and that there is no need to retreat from their maximum demands. A Pravda correspondent told Kingsbury Smith on 9 June that no progress on Indochina is likely until after the French government crisis is brought to an end. The Communist negotiators appear willing, however, to make some minor concessions in order to keep the conference going at least until they have been able to arrange further French-Viet Minh talks.

In the military conversations between the French and Viet Minh, the Communists are believed to be bidding for direct control of about three fourths of Vietnam, half of Laos and much of Cambodia. They have also continued to insist that Laos and Cambodia must be included in any political settlement.

Attempts are further being made by the Communists to set up bilateral political and military talks in the field as well as at Geneva. This appears to be in preparation for a breakdown of the conference and for a transfer of negotiations to Indochina in the style of the Panmunjom talks--a move which would enable the Communists to take advantage of a deteriorating military situation in Indochina and a critical political situation in France.

The All-Union Congress of Soviet Trade Unions convened in Moscow last week for the first time since 1949. At the opening session, N. M. Shvernik, an alternate member of the party presidium and head of all Soviet trade unions, delivered a lengthy report of the Trade Union Council. In unusually strong terms, Shvernik criticized broad segments of the Soviet economy for permitting poor labor productivity and neglecting the personal welfare of the workers. The ministers of coal, building materials, agriculture and the construction industry were attacked personally and six other economic ministries and the Ministry of Health were also criticized. This speech, while important for its broadside attack on the Soviet government, was probably intended primarily to create the illusion that an era of greater trade union authority was beginning.

Soviet announcements that collective farms have exceeded the 1954 spring sowing plan by about two percent suggest that the first phase of the regime's ambitious agricultural program outlined by Khrushchev earlier this year has been completed. The deciding factor in the success or failure of this year's program for increasing grain production will, however, be weather conditions.

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In Prague, the three major speeches delivered at the Czech Party Congress, which opened on 11 June, failed to reveal any major new themes, trends, or personnel shake-ups. The principal address, delivered on 11 June by First Secretary Antonin Novotny, was ostensibly a report of the central committee and dealt with the party's future tasks. In actuality it covered a wide variety of topics, with heavy emphasis upon the nation's economy. N.S. Khrushchev, first secretary of the CPSU and chief of the Soviet delegation, discussed Czech agricultural policy at some length on 12 June. Czech premier Siroky's speech, dealing with the national economy, stressed past failures and future corrective measures, especially in agriculture.

In general, all three speeches reaffirmed the major policies of the new course. The extraordinary emphasis on agriculture, however, confirms earlier indications that current economic planning calls for the allocation of greater resources for agricultural production than originally was stipulated in new course directives.

The delivery of the major address by First Secretary Novotny, instead of Siroky, may reflect congress protocol rather than party status.

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THE GOVERNMENT CRISIS IN FRANCE FOLLOWING THE FALL OF LANIEL

Unless Radical Socialist Mendes-France accepts Communist votes to attain an investiture majority, the search for a successor to Premier Laniel will probably be bitter and prolonged. The new premier is likely to continue Laniel's basic program, except that he will be under implicit instructions to end the Indochina war even at the cost of major concessions.

Except to demonstrate that Laniel had advocated firmer Indochina policies than the assembly would support, his overthrow settled no problems. While the various antigovernment forces in the assembly finally managed to reach agreement on deposing the premier, they are far from unanimous on either a successor or a program. The Communists have announced their intention to support any candidate opposed to EDC and continuation of the Indochina war, but it is unlikely that any prospective premier would accept investiture based on their votes. It now seems almost impossible for both Popular Republicans and Gaullists to serve in the same coalition, since the former insists on EDC ratification and most of latter are strongly opposed. While a right-center coalition including either the Popular Republicans or the moderate Gaullist group is possible, neither alternative is politically feasible.

The Mendes-France investiture attempt of a year ago showed that on economic issues it would be possible to get a government majority cutting across ordinary party lines; and at present, on the issue of EDC there is believed to be a potential majority in favor of ratification. Any such solution would, however, depend on Socialist support, if not participation, and Socialist leaders, convinced that the economic programs and Indochina policies of the governments in power since 1951 are unpopular, have consistently fought shy of such entanglements.

Of the various candidates mentioned in addition to Mendes-France, Coty is reported to prefer three who are pro-EDC: Popular Republicans Bidault and Robert Schuman, and ex-premier Pinay of the Independents, who is ill. Another candidate under presidential consideration is Radical Socialist Edgar Faure, who has in the past few months abandoned his earlier support of EDC. A further possibility is the youthful Francois Mitterrand, leader of the small

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Resistance Union, who resigned from Laniel's cabinet in September on the ground that France should withdraw from Indochina and concentrate on its African possessions. The assembly may end by turning in desperation to a political unknown as it did a year ago with Laniel.

Should the government be formed on the basis of a pro-EDC majority, some effort toward ratification may still be possible before the summer recess. Even with such a government, however, consideration of the treaty could well be further postponed in view of the assembly's overwhelming preoccupation with Indochina.

The assembly's determination to impose its will on the question of Indochina and at the same time avoid a showdown on the other major issue of EDC was shown by the way it chose to overthrow Laniel. Threats by both the premier and the president to force new elections were stymied when the Radical Socialists and the Gaullists carefully gauged the vote on 12 June so as to avoid defeating the government by the absolute majority of 314 which, under the constitution, would have permitted assembly dissolution and new elections.

Any intention of Laniel to remain in office despite the relative majority of 306-293 against him was dispelled when the Radical Socialist ministers insisted on the cabinet's resignation. Once Coty had officially accepted the resignation, another constitutional provision ruled out all possibility of a dissolution by cabinet decision until a new government shall have been in office for at least 15 days. Thus, the possibility of new elections--reported by the American embassy last week to be gaining increasing favor as a political solvent--has receded into the future.

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THE CONTINUING POLITICAL CRISIS IN VIETNAM

Bao Dai's actions to deal with the instability in his government since the fall of Dien Bien Phu, combined with the growing conviction on the part of the Vietnamese that the French will sell them out, have furthered political disunity in Vietnam.

The principal evidences of political deterioration are: (1) increased Viet Minh infiltration of areas nominally under French-Vietnamese control; (2) a strong neutralist and occasionally pro-Communist slant in the Saigon press; (3) a general lack of resolute and effective action on the part of Vietnamese officials.

Recent Viet Minh military moves have resulted in an increased flow of refugees into certain large cities of Vietnam. It is believed that many Viet Minh agents have entered Hanoi and Hué with the refugees. In the south, the Viet Minh is directing a widespread terrorist campaign against village officials, forcing them to conform or flee. In some of the larger cities, the Viet Minh has concentrated on organizing the drivers of pedicabs; these men were responsible for disorders which occurred in Haiphong early this month. It is believed that the Viet Minh will not, however, bring its expanding underground in the larger cities into the open until it considers that the final phase of the war has arrived.

Political deterioration is evident in the greater number of neutralist and Communist-line editorials appearing in the Saigon press. This breakdown of normally rigorous censorship at a time when it is most needed probably reflects Bao Dai's disastrous decision, more than a month ago, to sell the national police force to a Saigon gangster organization, the Binh Xuyen, for 40,000,000 piasters. Viet Minh capabilities were considered enhanced by this move.

The assumption of police power by the Binh Xuyen has resulted in the demoralization of the police force and widespread disgust among the population as a whole. It has, moreover, accentuated the clamor for privilege on the part of other political organizations in south Vietnam. Bao Dai reportedly plans to buy the continued good will of the Cao Dai politico-religious sect by offering it a padded payroll for troops which the Cao Dai has agreed to integrate into the national army. Cao Dai leaders would have access to the payroll surplus, which would presumably come out of American financial aid for the Vietnamese army.

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The general inability of the Vietnamese government to function is largely attributable to the absence from Vietnam of many of its top officials. This is particularly true in the case of Bao Dai, now on the French Riviera. The Vietnam government has always been hamstrung by the necessity of reconciling Bao Dai's deliberate aloofness from the day-to-day problems of government with the fact that any decision contrary to his wishes is apt to be abruptly vetoed. This problem is aggravated by his physical remoteness.

Moreover, Premier Buu Loc's ability to act decisively has been impaired by inconclusive moves made by Bao Dai toward establishing a new government under one Ngo Dinh Diem. In his usual fashion, Bao Dai has permitted a paralyzing suspense to develop over a period of weeks rather than coming to a prompt decision. A late press dispatch carries the report that Buu Loc has already submitted his resignation. Aside from the immediately harmful effects of Bao Dai's dilatory behavior, it is generally conceded that Diem rates well below Buu Loc in terms of political and administrative ability.

There is widespread doubt among the Vietnamese that the Viet Minh aggression can be stopped, but this appraisal of Vietnam's prospects has had a much less debilitating effect on morale than might have been expected. This appears to be especially true in those areas most directly threatened by the Viet Minh. Numerous reports show that the morale of officials throughout North Vietnam is remarkably good. Governor Tri, whom French officials described as "firm as a rock" in the face of enemy moves toward the delta, told the American consul that the fall of Dien Bien Phu had been less disturbing to the non-Communist population than was the possibility of a French sell-out at Geneva. The fact that Tri and other officials have repeatedly requested American intervention denotes anything but a defeatist attitude.

Defeatism seems more evident among certain French-oriented politicians of South Vietnam. Chief of Staff Hinh and his father, ex-premier Tam, have both made statements suggesting a desire to write off Tonkin and make a stand in the south. Tam admits that he favors revival of a long-latent scheme to set up a separate "Republic of Cochinchina."

Such a concept is regarded as tantamount to treason by the vast majority of Vietnamese nationalists. In the case of General Hinh, the writing off of Tonkin is apparently viewed merely as a step toward the realization of Hinh's dictatorial ambitions, since a Viet Minh take-over of Tonkin would conveniently eliminate Hinh's strongest anti-Communist political opponents.

THE LEFTIST CHALLENGE TO PARLIAMENTARY GOVERNMENT IN JAPAN

The left-wing campaign to discredit Japanese parliamentary institutions reached a climax on 3 June, when the Socialists resorted to organized "goon-squad" tactics to break up the final Diet session and prevent passage of the police recentralization bill. According to the American embassy in Tokyo, the riot was planned as a test of strength and led by pro-Communist elements of the Left Socialist Party, one of the two Japanese Socialist parties.

The incident may also have had anti-American overtones. Both the Right and Left Socialists boast that by forcing Prime Minister Yoshida to postpone his world tour, they prevented him from making new commitments to the United States which would be adverse to Japan's best interests.

The most alarming aspect of the incident is the refusal of a large number of conservatives to support Yoshida's call for stern disciplinary action. The resulting paralysis in the conservative camp is fresh evidence of the government's inability to lead in a crisis.

Meanwhile the press, instead of concerning itself with the attack on parliamentary institutions, has tended to place the blame for violence on the government. The newspapers have confused and misled the public by charging the conservatives with attempts to reimpose a police state through the "tyranny of the majority."

Yoshida's dictatorial methods and the recent government scandals have undermined his base of support. If he should attempt to resolve the impasse through dissolution of the Diet and new elections, his chances for regaining power are dim.

Barring some spectacular move to reassert his leadership, Yoshida's only alternatives are to resign or continue with a weakened and ineffectual government. Since most conservatives place Yoshida's removal ahead of combating the left, his position may become untenable over the next few months.

Yoshida's retirement would remove the sole major obstacle to a conservative merger. Although any successor would probably lack his strong personality and extreme pro-West attitude, conservative unity would ensure solid support for long-delayed economic and political measures to stabilize Japan along conservative lines.

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EAST GERMANS PASSIVE AS
COMMUNIST CONTROLS ARE STRENGTHENED

In the year that has elapsed since the uprising of 17 June 1953, the Communist East German regime has improved security controls and achieved a certain measure of domestic tranquillity. It is now probably in a better position than at any time in the past to meet threats of unrest or overt expressions of opposition.

Neither the Grotewohl regime nor the Soviet Union has gained in popularity. On the contrary, hatred of the Communist regime has solidified; but it is kept under control by the ubiquity of the secret police, and is tempered by the increase in the food supply and the inability of the West to devise a formula that would bring about a political change.

Since last year's riots, the East German regime has strengthened and reorganized the state security service under the Ministry of Interior. It has purged the military establishment of some of its political dissidents and increased the effectiveness of the armed forces by equipping them with weapons such as armored cars for suppressing disorders. In addition, it has organized an extensive system of party "alert groups" to control industrial workers and has increased efforts to indoctrinate and win over the peasantry. There is evidence, moreover, that the regime now is constantly on the alert for possible uprisings, and that resistance groups would not benefit from the element of surprise.

While a spark of resistance continues to smolder in the heart of the average East German, he is less inclined now to engage in hopeless attempts at overt resistance. Both the failure of the 17 June uprisings and the inability of the participants in the Berlin conference last January to reach agreement on the unification of Germany added to his passive resignation. When the East German populace saw every hope for unification slip away in the verbiage of the conference, it fell into an attitude of indifference, characterized by a willingness to live with the regime and make the best of a bad situation.

Measures taken by the government to improve the supply of food and consumer goods have also contributed to the general acceptance of existing conditions. Food and consumer goods have been imported from the Soviet Union and the Satellites, or purchased in Western countries, and the output of domestic

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consumer goods industries has been increased. The resignation to existing conditions has been reflected in a decline in the number of persons fleeing to the West. In March 1954, 18,054 refugees fled to West Berlin and West Germany, compared with 50,048 during March 1953.

Three recent developments illustrate the growing confidence of the regime in its ability to maintain internal security. The staging of the youth rally in East Berlin on 5-7 June shortly before the anniversary of the 17 June riots seemed a bold gesture likely to tempt disaffected elements to demonstrate against the regime. The East German Communists succeeded, however, in bringing approximately 450,000 youths to East Berlin who paraded in an orderly, disciplined--although listless fashion--before their leaders. The opening of the Baltic coastal area--which for two years had been a restricted zone--to free access on 1 June is a further measure of the regime's confidence. Finally, the party has now claimed publicly that it has eliminated organized resistance among East Berlin construction workers, who were the moving force in last year's June riots.

A considerable amount of organized resistance remains, however. Some opposition to the regime's policies has also developed in such mass organizations as the trade union federation and the Free German Youth, and even within the Socialist Unity Party (SED). It is evident that the presence of Soviet forces will be necessary until the security police and party controls have been strengthened to the point where the regime can independently maintain its supremacy. Barring external changes which would alter the status of East Germany, the combination of efficient police control, popular passivity and improved economic conditions will in time permit the East German regime to consolidate its position.

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COMMUNISTS INCREASE ACTIVITIES IN EGYPT

Communist activity in Egypt has increased markedly during the past eight months, despite a continuing roundup of Communist agitators and of the small number of hard-core members. During the same period, the USSR and the Satellites have stepped up their cultural and commercial ties with Egypt, and the Nasr regime has indicated interest in developing closer economic relations with the Orbit.

Recent reports indicate that Communist factions in Egypt are more extensive and better organized than was previously believed. There are between 500 and 1,000 Communists organized in groups capable of conducting clandestine activities. The total number of Communists and sympathizers associated in front organizations is considered to be less than 4,000. During the past year the numerically small Egyptian Communist Party and two segments of the Haditu--a much larger Communist group--have been the most active.

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The Communists are devoting considerable attention to the army, and some officers are known to be Communists. It is not clear, however, whether officers arrested in connection with plans for an alleged coup in April were Communists or in contact with Communist groups, despite that charge by the regime.

The current political situation in Egypt affords the Communists a favorable milieu in which to operate. Since political parties are outlawed, all political activity has been forced underground and there are reports of Communist infiltration of the clandestine operations of the Wafd Party and the Moslem Brotherhood. The Communists are likely to exploit the antiregime activities of these two groups, both possessing extensive organizations throughout the country.

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During the past eight months, the USSR and the Satellites have made a concerted effort to develop closer relations with Egypt. In November, an Egyptian economic mission toured the Orbit, where it received preferential treatment and was reported considerably impressed. In the following months Czechoslovakia, Hungary and East Germany had commercial exhibits in Cairo.

In January, Egypt concluded a trade agreement with Rumania and in March signed a trade pact with the USSR. A significant feature of this agreement was the stipulation that all agents for Soviet goods in Egypt must be either Egyptian or Soviet, thereby affording the USSR the opportunity to establish state trading organizations in Egypt which could become instruments for Soviet activities.

There has been a similar increased emphasis on Egyptian-Soviet relations in the diplomatic field. In October 1953, a new and more active Soviet minister arrived in Cairo, and in March of this year, Egypt and the USSR raised their respective missions to embassies. Another indication of the Soviet Union's increased interest was its decision to assign a military attaché to Cairo. The USSR is also reported anxious to establish a cultural institute in Cairo.

There is evidence that a few Communists and Communist sympathizers in Egypt may actually be occupying influential posts in the Nasr regime

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Brigadier Hasan Raghab, under secretary of state for war and leader of the Egyptian economic mission which spent four months visiting the Orbit, returned to Cairo in March thoroughly impressed by Soviet industrial achievements. Raghab is one of the key officers in the army and highly regarded by the Nasr regime. He is considered one of the most pro-American members of the regime. In an April conversation with the American army attaché in Cairo, Raghab emphasized the industrial benefits that the Satellites had received from the USSR. He also expressed his conviction that within three years Soviet industrial might would be invincible. Other sources support the belief that "some Red brushed off" on Raghab during his Orbit visit.

If the Nasr regime fails to obtain an early settlement of the Suez dispute, it is likely to adopt an increasingly anti-Western attitude which would afford both Egyptian Communists and the Orbit an opportunity to strengthen their positions.

SPECIAL ARTICLEWESTERN EUROPE'S ECONOMIC IMPROVEMENT AND AMERICAN
POLICY OBJECTIVES

A general upward trend in Western Europe's economy* has been evident over the past 16 months and is still continuing, but various basic weaknesses have not yet been overcome. The short-term gains have advanced the fundamental American security interests in the area. At the same time, the reduction in Europe's dependence has fostered a disposition toward policies not in line with American objectives.

Short-term economic improvement

Key indicators of West European economic activity during the past 16 months reveal a general easing of shortages and rise in output, but do not show impressive growth in productive power (see charts, p.18). However, higher levels of production and growing dollar balances contrast with the weakness registered in 1952, after the Korean armistice; and the rising trend has thus far weathered the economic readjustment in the United States.

Production:

Western Europe's aggregate gross national product increased by 4 percent in 1953, as compared with 2 percent in 1952 and an average of 6 percent in 1950 and in 1951. The 1953 increase was 0.4 percent above the increase achieved by the United States in 1953 and would, under normal circumstances, indicate a healthy rate of growth. An annual increase of considerably more than 4 percent is necessary, however, if Europe is to meet its defense requirements and provide urgently needed improvements in living levels for a growing population.

The rise in Western European industrial production has continued during the first half of 1954. Figures for 1953 show expansion of industrial output of 10 percent in Italy, 9 percent in Western Germany, and 6 percent in Britain. Though there was a 3-percent decline in France in 1953, French industrial output was again rising this past spring and in April was 7.6 percent higher than a year earlier.

Most of the over-all rise of 5 percent in total industrial output was attributable to increases of 16 percent in production

*All data from reports of the Organization for European Economic Co-operation (OEEC). Member countries of the OEEC are: Austria, Belgium-Luxembourg, Denmark, France, West Germany, Greece, Iceland, Ireland, Italy, the Netherlands, Norway, Portugal, Sweden, Switzerland, Turkey, and the United Kingdom.

by the textile and chemical industries. Other industries did not expand significantly, except for electricity production which rose 5 percent. The index for steel production was down 2 points.

International Payments:

Western Europe's payments and monetary reserve situation has improved markedly since 1952. The 1953 increase in total imports paralleled the rise in industrial production at 5 percent. However, dollar imports from the United States and Canada were down 15 percent, while exports to these countries increased 20 percent, contributing to the reduction in the dollar deficit, before American defense receipts, from \$3.87 billion in fiscal 1952 to \$588,000,000 in fiscal 1953. Inflationary pressures had abated by 1953, and terms of trade between Western Europe's manufactured goods and imported primary materials were advantageous. Increased agricultural production somewhat reduced the expenditures for imported foodstuffs. Gold and dollar reserves rose from \$9.4 billion in December 1952 to \$11.5 billion in December 1953, and had reached a level of \$12.0 billion by March 1954.

These improvements in foreign trade and finances greatly facilitated the liberalization and expansion of intra-European trade. It is now generally expected that most, if not all, Western European currencies will achieve at least limited dollar convertibility by the end of 1954. There has been general agreement to work co-operatively to this end, and only Italy has formally indicated serious concern that it will be unable to move toward convertibility at the rate projected.

Longer-term outlook

Optimism based on these records of improvement in production and finances must be qualified. They were made possible by large American defense expenditures which are scheduled to decline and by a high plane of economic activity in the United States which has leveled off since the third quarter of 1953.

Without American military expenditures, no Western European country would have had a significant dollar surplus in fiscal 1953, and the combined deficit would have been \$588,000,000 instead of the actual surplus of \$1.73 billion. American officials estimate that presently contemplated American defense outlays will convert deficits of over a billion dollars in 1954 and in 1955 into surpluses of \$1.83 billion and \$1.79 billion respectively. This form of dollar support is scheduled to fall off in 1956.

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The future of the American economy is considered the major question mark in Europe's economic outlook. Expansion of industrial output held up during the last quarter of 1953, despite contraction in the United States, but there has been a significant drop in exports to the United States and Canada since last November.

The desire in Europe for sufficient exports to the United States to balance payments has prompted serious concern over American trade policy. British officials have frequently stated that London's action on monetary and trade policy, particularly with reference to currency convertibility, will be directly affected by the response in Washington to the Randall Commission's recommendations for trade liberalization.

For the longer term, European economic progress is seen by OEEC experts as depending on a correction of the restrictive practices which characterize the entire economy. These are reflected in the fundamental fear of competition and resistance to technological change among workers and management alike. The result is expressed in labor's opposition to the introduction of labor-saving processes and in management's addiction to cartel practices.

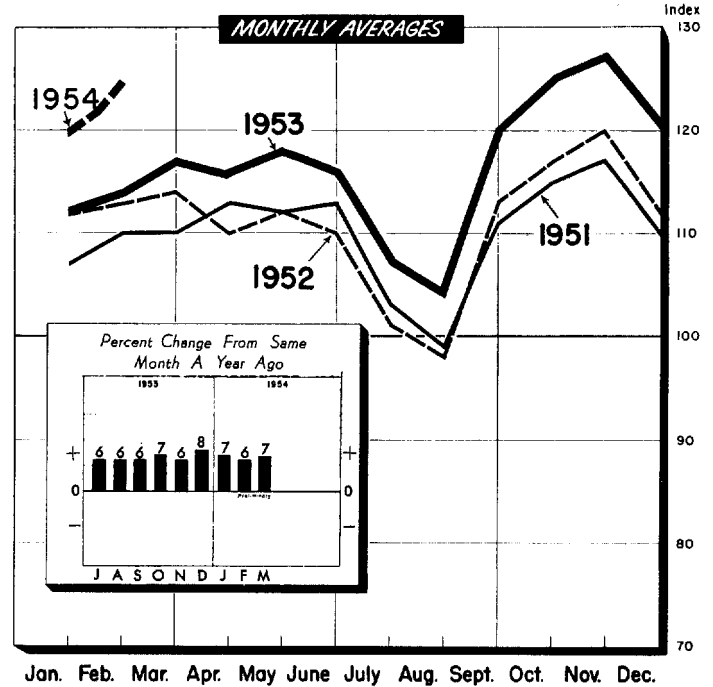
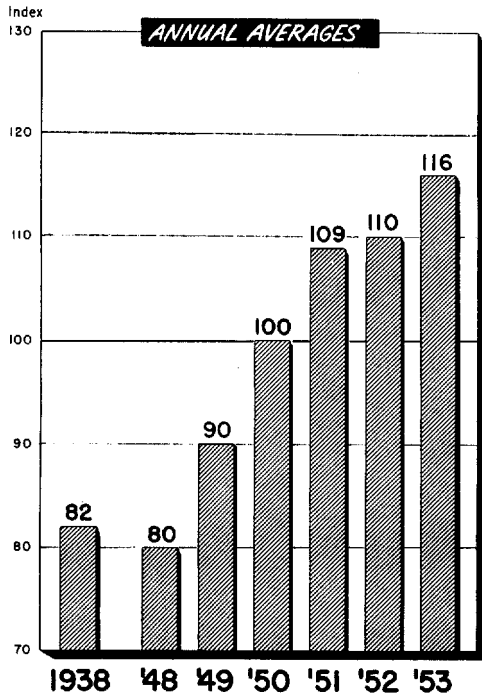
Implications for American policy

This traditional resistance to the basic changes necessary to develop a dynamic economy and the recent short-term economic improvements in Western Europe combine to complicate the attainment of certain American policy objectives. The short-term economic improvement, by reducing Europe's dependence on American aid, has weakened incentives for co-operation. Increased confidence as well as sharpened competition in the free world market have persuaded the British to spearhead a widely supported drive to relax COCOM restrictions on certain products for which they believe there is a market in the Soviet bloc. In West Germany, Chancellor Adenauer has in recent weeks made explicit the previously implicit desire for normalizing trade relations with the Orbit. Commercial rather than strategic considerations seem to have acquired increased priority in other European capitals, and the protection of genuine strategic interests in these matters has become increasingly difficult.

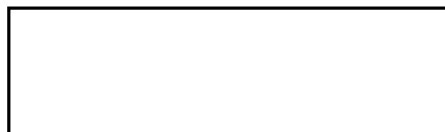
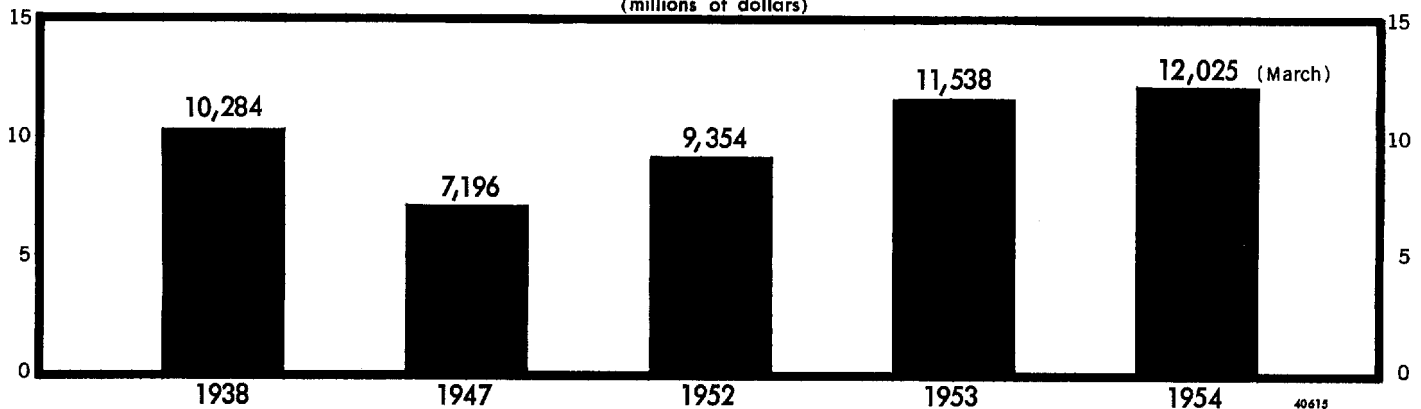
Long-range programs for integration of the European economy have also encountered considerable difficulties during the past year. The general atmosphere of economic well-being encourages an attitude of "business as usual" and makes the national governments reluctant to take aggressive measures in support of somewhat distant goals.

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EUROPEAN INDUSTRIAL PRODUCTION **TOTAL FOR OEEC COUNTRIES: 1950=100** *Not Seasonally Adjusted*



OEEC COUNTRIES **TOTAL GOLD AND SHORT-TERM DOLLARS** (millions of dollars)



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